Global Research
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INDIAN ECONOMY

CRISIL Insights

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Through the monthly CRISIL Insights Indian Economy series, we offer incisive analysis of macroeconomic parameters of the country. We turn our attention to the economic steps the government needs to focus on after three years in office.

3 years after, 3 key takeaways

In May 2017, the Narendra Modi-led National Democratic Alliance will complete three years of its five-year term. Three key highlights of the third year of the NDA are:

(1) Passage of the Goods and Services Tax by Parliament, which will likely usher in significant benefits and lift India's growth trajectory.

(2) Demonetisation of high denomination currency, which is being leveraged to move India towards a 'less-cash' economy and fomalised economy.

(3) Consolidation of political power by the ruling party which show it is possible for a government to take hard decisions without eroding political capital.

The reform momentum and political mandate will mean India will continue to improve its competitiveness ranking and remain an attractive investment destination.

From a global context, India stands out for two reasons – stable macros and prudent fiscal and monetary policies. India's growth-inflation mix has improved, durably. Fiscal and monetary policies are more prudent, focussing on raising the quality of growth and not just the rate of growth.

Yet, many areas need improvement and slow progress is limiting upsides.

Investments remain a drag on growth. Weak balance sheets of companies and low capacity utilisation continue to be deterrents.

Second, the fiscal health of the states, which are now being projected as the engine of growth, needs to be improved.

Thirdly, mounting bad loans in the books of banks impair their ability to aggressively finance growth.

One of the stated objectives of the Modi government was to empower the states. The dismantling of the Planning Commission together with increasing the share of states in central tax revenues, has meant states now have greater flexibility in spending the transfers received from the Centre.

Most of the reforms initiated by Modi government continue to be work in progress. The remaining two years should focus on effective implementation of the reforms and measures already announced.

GDP	Inflation	Interest Rate	Rupee
IIP declines as manufacturing shrinks	CPI inflation up on higher fuel; core stays stubborn	Inflation and liquidity drive RBI to maintain status quo	Rupee on a roll

GDP

- February IIP growth came in at -1.2% on-year, after a positive growth in the previous month
- The poor IIP performance was largely on account of 2% contraction in manufacturing IIP
- The decline in IIP can be attributed to consumer-oriented sectors, which performed poorly for the third consecutive month, possibly suggesting the impact of cash crunch that followed demonetisation is still at play
- Consumer goods production continued to decline with both durables and non-durables facing heat

INFLATION

- While consumer price inflation (CPI) inched higher in March, led by higher fuel inflation, WPI inflation declined
- Core CPI inflation continued to stay sticky. Stubbornness in core inflation has kept the central bank vigilant on upside pressures
- For fiscal 2017, CPI fell to 4.5% average from 4.9% in fiscal 2016 mainly led by the effect of demonetisation on perishables, while WPI rose to 3.7% from -2.5% due to rising oil and commodity prices.
- The sharper-than-expected fall in inflation over the past few months – led by a plunge in perishables inflation because of demonetisation – has already started correcting as remonetisation gained currency

INTEREST RATE

- The monetary policy committee left the policy repo rate unchanged at 6.25%, and retained its 'neutral' monetary policy stance
- To make the Reserve Bank of India's liquidity stance consistent with its monetary stance, the policy rate corridor was narrowed from 50 basis points to 25 basis points
- Despite rapid remonetisation and an increase in currency in circulation, liquidity remained flush as bank deposit growth stayed high and credit growth dipped below 4%
- The RBI has telegraphed a glide path with milestones of 5% inflation in the second half of fiscal 2018 and 4.6% in the fourth quarter of fiscal 2019, while citing continuing upside pressures

RUPEE

- Rupee closes March at 64.8/dollar, up 2.8% on-month, driven by a surge in foreign capital inflows
- Foreign portfolio investors flocked to India in March, pouring in $8.6 billion – $4.7 billion in equities and $3.9 billion in debt
- The Modi government's victory in state elections and passage of the GST bill boost the sentiment of foreign investors
- Dollar weakens further as President Trump's healthcare reform bill is rejected

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Debt	Equities	Trade	Global Developments
Yields slip on high liquidity, FII hunt	NDA victories lift the Street	Global tailwinds nudge India's export recovery	Inflation makes a comeback, worldwide

DEBT

- Yield on the 10-year government security (G-sec) ended March at 6.69%, down 18 basis points on month
- A surge in foreign institutional investment in the Indian debt market and abundant systemic liquidity led to higher bond prices and lower yields
- CRISIL expects the 10-year G-sec yield to settle around 6.9% by March 2018

EQUITIES

- Bharatiya Janata Party's electoral victories in key states, including in Uttar Pradesh, pushes Nifty past the 9000 mark
- While stocks of consumer durable companies picked up with the passage of the Goods and Services Tax (GST) bill, fall in global commodity prices dampened gains in auto and metal stocks
- Global indices posted modest gains as global uncertainties triggered caution

TRADE

- With strengthening global economic recovery, exports record first double digit growth in February since 2014
- Imports grew faster, fuelled by oil and gold
- Services trade shrinks further, as exports fail to keep pace with imports

GLOBAL DEVELOPMENTS

- Fourth quarter gross domestic product (GDP) in the US grew 2.1%. The economy added 98,000 non-farm jobs during March, the lowest payroll number since May 2016. The rising inflation prompted the Federal Open Market Committee to raise the target range for the federal funds rate by 25 bps to 0.75-1% on March 15.
- As per the estimate of Eurostat, the statistical office of the European Union, seasonally adjusted Euro-area GDP rose 0.4% on-quarter (not-annualised) in Q4. Inflation accelerated 20 bps on-month to 2.0% in February. The European Central Bank is maintaining easy monetary conditions.
- Japan's Q4 GDP grew at 1.2% (annualised) on-quarter, same as growth in Q3. Annual CPI inflation remained positive for five months in a row, at 0.3% in February, falling 10 bps over the previous month.
- China's GDP grew 6.8% on-year in Q4, compared with the 6.7% growth clocked in the previous three quarter. The annual CPI-linked inflation rose 0.8% in February, 170 bps lower on-month. China kept its benchmark lending rate unchanged at 4.35%.
- As per the World Bank's pink sheet, all commodity price indices declined in March. Brent crude slid for the first time in the past three months to $51.6 per barrel on average in March.

Source: CRISIL Research

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